

Internal Control Audit of the

Department of Consumer Affairs Cash Disbursements by Agency Checks

January 2008

Audit No. 2007-102



Internal Audit Office

INTERNAL AUDIT OFFICE

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January 30, 2008

Scott Reid, Chief Deputy Director
Executive Office
Department of Consumer Affairs
1625 N. Market, Suite S-308
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Subject: Internal Control Audit Report – Cash Disbursements by Agency Checks

Enclosed is our audit report of the department's internal control over its agency check handling practices. We performed this audit to assist the department in complying with the Financial Integrity and State Manager's Accountability Act of 1983, which requires an assessment of the adequacy of internal controls. Our audit identified several reportable conditions for which controls could be improved. If left uncorrected, these conditions increase the risk that material errors or irregularities could occur and remain undetected.

We have included our specific findings and recommendations in the attached report. As outlined in its response, the department concurred with our audit findings and has already implemented some corrective actions. The department also plans to implement additional corrective actions to address the remaining audit issues. We plan to follow-up on the department's progress in implementing its corrective actions at 180 and 360 days from the audit report date. The department's 180-day and 360-day responses will be due July 30, 2008, and January 30, 2009 respectively.

We would like to thank the Office of Administrative Services and its staff for their cooperation during the audit. If you need further information, please call me at (916) 574-8190.

Sincerely,

A handwritten signature in black ink, appearing to read 'Walter Durette'.

Walter Durette
Acting Audit Chief

Attachment

cc: Kitty Williamson, Deputy Director, Administrative & Support Services
Audit Committee Members

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**Department of Consumer Affairs
Internal Control Audit
Cash Disbursements by Agency Checks
January 2008**

The Department of Consumer Affairs' (department) Internal Audit Office completed an accounting and administrative control audit of the department's agency check handling practices, as required by Section 20000 of the State Administrative Manual (SAM). The purpose of the audit was to assist the department in complying with the Financial Integrity and State Manager's Accountability Act (FISMA) of 1983, which requires an assessment of the adequacy of internal controls. We reviewed the department's agency check handling practices to determine whether adequate internal controls were in place to ensure compliance with state requirements and sound management practices.

The department's Accounting Office is responsible for payment of claims for goods and services to a vendor or employee. As part of this function, the Accounting Office may submit its claims to the State Controller's Office to make direct payment by issuance of a warrant, or where immediate payment is necessary, make these payments through checks drawn against the agency's Office Revolving Fund and General Cash account. Our audit focused on control of the agency checks used to satisfy immediate payment needs through the department's agency bank accounts.

In evaluating the department's agency check handling practices, we interviewed pertinent personnel and reviewed relevant documentation and processes. We performed compliance testing of key functions and compared actual operations to applicable laws, regulations, and guidelines. Our audit test period was from July 1, 2006, through September 30, 2007; however, we expanded the test period in certain instances when it was deemed appropriate. Our audit was conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing* issued by the Institute of Internal Auditors. The last day of fieldwork was on January 7, 2008.

Our audit identified several reportable conditions for which controls could be improved. If left uncorrected, these conditions increase the risk of material errors or irregularities occurring and remaining undetected. We met with departmental personnel on January 10, 2008, to communicate our audit results. The internal control weaknesses below are addressed in greater detail under the Findings and Recommendations section of this report:

- The department needs to maintain full accountability of agency check stocks.
- Agency checks are not always processed properly or issued timely.
- Control over the check signing machine keys and facsimile hand stamps are inadequate.
- The department lacks adequate separation of duties over the handling of agency checks.
- Complete records of signed checks are not maintained to ensure accurate reconciliation.

This report is intended for the information and use of the department and should not be used for any other purpose. However, the report is a matter of public record and its distribution is not limited.

We have completed an audit of the accounting and administrative control of the Department of Consumer Affairs (department) agency check handling practices, in effect as of January 7, 2008. Our audit was conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing* issued by the Institute of Internal Auditors, and included audit tests we considered necessary in determining that internal controls over the handling of agency checks are in place and operative.

Management is responsible for establishing and maintaining adequate internal control. This responsibility, in accordance with Government Code (GC), Sections 13402 et seq., includes documenting internal control, communicating requirements to employees, and assuring that internal control is functioning as prescribed. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of accounting and administrative control are to provide management with reasonable, but not absolute, assurance that:

- Assets are safeguarded against loss from unauthorized use or disposition.
- Transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of reliable financial statements.
- Financial operations are conducted in accordance with policies and procedures established in the State Administrative Manual.

Our responsibility is to express an opinion on the adequacy of the department's agency check handling practices based on our audit. Accordingly, our audit included obtaining an understanding of internal control over agency check handling activities; testing and evaluating the effectiveness of the internal control related to this area; and performing such audit procedures as we considered necessary under the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Because of inherent limitations in any internal control structure, misstatements due to error or fraud may occur and not be detected. Also, projection of any evaluation of the internal control over agency checks to future periods is subject to the risk that the internal control may be adversely affected by changes in conditions that render it inadequate, or that the degree of compliance with policies and procedures may deteriorate.

Our audit identified several internal control weaknesses relating to the department's handling of agency checks. The following material weaknesses were noted:

- The department needs to maintain full accountability of agency check stocks.
- Agency checks are not always processed properly or issued timely.
- Control over the check signing machine keys and facsimile hand stamps are inadequate.
- The department lacks adequate separation of duties over the handling of agency checks.
- Complete records of signed checks are not maintained to ensure accurate reconciliation.

Except for the effect of the weaknesses described in the preceding paragraph, the department maintains adequate internal control over the agency check function as of January 7, 2008, based on the requirements of GC section 13400 et seq.

This report is intended for the information and use of the department and should not be used for any other purpose. However, the report is a matter of public record and its distribution is not limited.

Original Signed By Walter Durette

Walter Durette, Acting Audit Chief
Department of Consumer Affairs
Internal Audit Office

January 7, 2008

BACKGROUND

The Financial Integrity and State Manager's Accountability Act (FISMA) of 1983 was enacted to ensure that state internal controls are in place and operative. Management is charged with the responsibility of establishing and maintaining internal accounting and administrative control for the department. This responsibility includes documenting internal control, communicating control requirements to employees, and assuring that internal controls are functioning as prescribed and are modified, as appropriate, for changing conditions. Internal control is defined as a process designed to provide reasonable assurance in achieving objectives in the following areas: (a) reliability of financial reporting; (b) effectiveness and efficiency of operations; and (c) compliance with applicable laws, regulations and policies.

The department's Accounting Office is responsible for payment of claims for goods and services to a vendor or employee. As part of this function, the Accounting Office may submit its claims to the State Controller's Office to make direct payment by issuance of a warrant, or where immediate payment is necessary, make these payments through checks drawn against the agency's Office Revolving Fund and General Cash account. Our audit focused on control of the agency checks used to satisfy immediate payment needs through the department's agency bank accounts.

The Office Revolving Fund may be used for payment of compensation earned, traveling expenses, traveling advances, or where immediate payment is otherwise necessary. Agency payments made from the General Cash account for the most part, are for bank buybacks of dishonored checks and other purposes such as salary garnishments for child support and income taxes owed by employees.

The Centralized Cashiering Unit (CCU) is custodian of the department's blank check stocks for the two agency accounts. CCU responsibilities include hand typing checks for payroll/salary advances and bank buybacks; signing agency checks with a check signing machine or facsimile signature hand stamp; and distributing checks to authorized personnel at the cashier's window, through the mail, or by courier service.

The CALSTARS Unit is also responsible for various functions over the agency check preparation function. The CALSTARS Unit, on a daily basis, releases check batches in the CALSTARS accounting system; runs daily batches to print agency checks; compares signed checks to authorizations and supporting documents; maintains blue foil copies of checks

written; compares the total number of checks signed with daily check signing logs prepared by CCU and performs monthly bank reconciliations of the Office Revolving Fund and General Cash accounts.

OBJECTIVES, SCOPE AND METHODOLOGY

The audit was performed in accordance with the *International Standards for the Professional Practice of Internal Auditing*. The audit objectives were to determine whether:

- Proper policies and procedures are in place to safeguard and provide accountability over agency check writing activities.
- Adequate separation of duties exists.
- Agency checks are properly authorized, processed and recorded timely.

The audit methodology included interviewing key personnel, reviewing documentation, and performing compliance testing, on a sample basis, as deemed necessary. The audit test period was from July 1, 2006, through September 30, 2007; however, we expanded the test period in certain instances when it was deemed appropriate. The last day of audit fieldwork was January 7, 2008.

FINDINGS AND RECOMMENDATIONS

FINDING 1

The department needs to maintain full accountability of agency check stocks.

CONDITION:

Our audit found several weaknesses over the accountability and control of blank check stocks. The following conditions were identified:

- A. The department did not properly keep agency check stocks under strict control at all times to prevent unauthorized use. CCU staff did not always secure blank checks that were detached from the stock box for hand typed checks. In fact, CCU staff at times left these blank checks unsecured around their work area when not in use. In addition, when the blank check stock boxes were carried over to the CALSTARS Unit for batch printing, the boxes at times were also left unsecured at unattended workstations.
- B. The department does not maintain transfer receipt documentation when blank check stocks are transferred to the CCU check typist, the CALSTARS Unit for batch printing, or when unused check stocks are returned back from the CALSTARS Unit to CCU. Absent transfer documentation, it would be difficult to provide for full accountability of the checks in the event of irregularities.
- C. CCU prematurely detaches a series of approximately 10 blank checks from the stock box when immediate use is not required. We reviewed a series of blank checks detached from the stock box for the month of September 2007 and found that these checks were not used until two to nine working days after they were detached. Premature removal of checks from the stock boxes makes it more difficult to account for and reconcile checks used to allow for timely detection of stolen or missing checks.

CRITERIA:

State Administrative Manual (SAM) Section 8041 requires agencies to keep check stock under strict control at all times and in accordance with SAM Section 8080. Transfer of check stock between persons will be acknowledged by transfer receipts showing the check numbers of the stock transferred. These receipts will be kept by the transferor and transferee.

RECOMMENDATION:

We recommend the department:

- Develop and implement adequate policies and procedures to include proper securing of blank checks at all times.

Finding 1

- Use transfer documentation showing the check numbers of the stock transferred and persons transferred to.
- Discontinue the practice of removing blank checks from the stock box if CCU does not intend on hand typing the checks immediately.

FINDING 2***Agency checks are not always processed properly or issued timely.*****CONDITION:**

The results of our compliance testing revealed agency checks are not always properly reviewed, accounted for, or processed timely. We tested 24 agency checks issued in September 2007 and found the following deficiencies:

- A. Eleven checks were not proofed to ensure the signed checks agreed with invoice amounts and initiating disbursement documents (payee, check request, purchase orders, etc.).
- B. Six checks were distributed without any signatures on them.
- C. Three checks were not properly recorded on the corresponding support documents in accordance with state requirements.
- D. Three checks were distributed and the distribution method was not documented. As a result, we could not determine if these checks were inappropriately routed back to the person who prepared or approved the payment.
- E. Some checks took up to 16 days to process after they were printed. We found some of the delays were attributable to the time it took CCU to record the check numbers on support documents and/or have the actual checks signed. We believe these delays may be excessive considering the fact that agency checks are to be used where immediate payment is necessary.

CRITERIA:

SAM Section 8080 requires the person who prepares checks to mark authorizations and supporting documents with the check number in ink in such a manner as to prevent their reuse.

SAM 8110 states revolving funds drawn may be used only, in accordance with law, for payment of compensation earned, traveling expenses, traveling expense advances, or where immediate payment is otherwise necessary.

Government Code (GC) Section 13403 states the elements of a satisfactory system of internal accounting and administrative controls shall include a system of authorization and recordkeeping procedures adequate to provide effective accounting control over assets, liabilities, revenues, and expenditures and an established system of practices to be followed in performance of duties and functions in each of the state agencies.

RECOMMENDATION:

We recommend the department develop and implement policies and procedures to provide for a systematic approach to processing agency checks and train staff in the use and adherence of those

Finding 2

procedures. The policies and procedures should include, but not be limited to:

- Internal time goals for processing the checks.
- A clear delineation of roles and responsibilities of staff involved in each step of the process.

FINDING 3***Control over the check signing machine keys and facsimile hand stamps are inadequate.***

The department has not taken proper precautions to prevent unauthorized use of the check signing machine keys and facsimile signature hand stamps. In fact, the department lacks established procedures to ensure the keys and stamps are properly assigned, accounted for, and secured. The following conditions were noted:

- A. The Accounting Office was unable to account for all of the facsimile hand stamps containing the Fiscal Officer's signature used to sign agency checks. There is no inventory or records of the number of stamps assigned and to who they were assigned.
- B. We identified four CCU staff who had physical custody of the facsimile signature hand stamps. Management was not aware that two of the staff had these stamps. In addition, for the period from March through October 2007, eight different CCU employees used the hand stamps to sign agency checks when only four were assigned these duties. In some instances, it appeared the stamps were taken from the assigned staff's work area without their knowledge.
- C. We noted several CCU staff used the check-signing machine when they were not actually assigned the keys to the machines.
- D. The department does not have the required authorization from the Department of Finance (DOF) to use rubber stamped signatures to sign checks.

CRITERIA:

SAM Section 8081 requires the person, whose signature is used, to control the key, and if that person is not available, the key may be assigned to a responsible person other than the operator of the check signing machine. The operator will lock the machine and remove the key whenever the machine is not in use.

SAM Section 8082 states that departments considering use of rubber stamp facsimile signatures for check signing contact DOF, Fiscal Systems and Consulting Unit, for authorization. Precautions must be taken to prevent the unauthorized use of rubber stamped signatures. When the stamps are not in use, they should be locked in a secure place with the key in the custody of the person authorized to sign checks.

RECOMMENDATION:

We recommend the department:

- Develop and implement policies and procedures to control the check signing machine keys and facsimile hand stamps and limit access to only authorized staff. Adequate separation of duties should be considered when assigning the hand stamps

Finding 3

and keys as detailed in Finding 4.

- Obtain the required authorization from DOF in order to use rubber stamped signatures to sign checks, or discontinue the use.

FINDING 4

The department lacks adequate separation of duties over the handling of agency checks.

CONDITION:

Our audit identified several employees who had incompatible duties over handling of agency checks. This can result in errors, irregularities and misappropriation of assets.

- A. In the CCU, four employees have the ability to perform incompatible duties:
 - Three employees have the ability to authorize disbursements by entering batch transactions and/or requesting checks to be written and distributing these checks.
 - The CCU Manager has access to the blank check stocks stored in the secured room and has also been found to sign checks.
- B. In the CALSTARS Unit, four employees have the ability to perform incompatible duties:
 - The CALSTARS manager has access to blank check stocks, can sign agency checks, compare signed checks to supporting documents, reconcile bank accounts, authorize disbursements by entering batch transactions and releasing these batches, and can print the batch checks.
 - One staff has access to the blank check stocks and has the ability to sign checks.
 - Two employees have access to blank check stocks, compare signed checks to supporting documents, reconcile the agency bank accounts, and prepare batch runs on checks. While the CALSTARS Unit strive to separate the duties for the Office Revolving Fund and General Cash accounts, we found that one staff performed all three duties for both accounts because one of the positions is currently vacant.

CRITERIA:

SAM Section 8080.2 states for departments whose accounting systems include manual and automated processes, SAM Sections 8080 and 8080.1 should be used in combination to provide adequate separation of duties.

SAM Section 8080 states in part that, "No one person will perform more than one of the following seven types of duties":

1. Receiving and depositing remittances
2. Authorizing disbursements
3. Preparing checks
4. Operating a check signing machine*

-
5. Comparing machine-signed checks with authorizations and supporting documents (or signing checks manually after personally comparing them with authorizations and supporting documents).*
 6. Reconciling bank accounts and posting the General Ledger or any subsidiary ledger affected by cash transactions*
 7. Initiating, or preparing invoices

*Duties 4, 5, and 6 will not have access to or control blank check stock.

Additionally, checks will not be routed for mailing or distribution through the person who authorized the disbursement or prepared the check.

SAM Section 8041.2 states that Checks will be delivered directly to the payee by either (1) U.S. mail, (2) messenger service in a sealed envelope, or (3) a person having no connection with either preparing or approving the claim or invoice. A check will not be routed through the person who prepared or approved the related travel expense claim or invoice nor will it be returned for mailing or distribution to the person who prepared it.

RECOMMENDATION:

We recommend the department review the distribution of duties over the handling of agency checks to ensure adequate separation of duties exists in accordance with SAM.

FINDING 5

Complete records of signed checks are not maintained to ensure accurate reconciliation.

CONDITION:

Agency checks are not always logged after they are signed (either by machine or hand). In addition, the checks are not signed and logged in the same order as they are printed making it difficult to reconcile and provide accountability of used checks. Our audit tests found several Office Revolving Fund checks prepared in September 2007 were not logged on the "Check Signing Machine Log."

The CALSTARS Unit performs a daily comparison of the checks signed against checks prepared. In order to account for all of the signed checks, the unit at times needs to supplement the "Check Signing Machine Log" with its blue foil copies of checks. This practice may not allow for the timely detection of missing and/or stolen checks because the blue foil copies may not always be forwarded.

CRITERIA:

SAM Section 8081 - The person assigned to compare signed checks to authorizations and supporting documents will compare daily or have his secretary compare daily the meter reading on the machine with what it should be according to his log of checks reviewed and signed by machine. At least once each week he will personally make the comparison with the meter reading. All voided checks will be retained by the person who reviews checks until completion of the following reconciliation.

RECOMMENDATION:

We recommend the department accurately log all checks signed by machine and hand. The checks should be logged in a sequential manner to ensure accurate reconciliation and timely detection of missing checks.

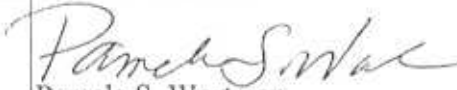


ATTACHMENT I

Department's Response to the Draft Report



MEMORANDUM

DATE	January 25, 2008
TO	Walter Durette, Acting Chief Internal Audit Office
FROM	 Pamela S. Wortman Fiscal Officer
SUBJECT	Cash Disbursements by Agency Checks Audit (Audit No. 2007-102)

Attached is the Office of Administrative Services' initial response to the Internal Control Audit of the Cash Disbursements by Agency Checks, Audit No. 2007-102.

If you have any questions, or need additional information please contact me at (916) 574-7172.

cc: Kitty Williamson, Deputy Director
Mary Cather, Cal-Stars Manager
Karen Calamia, Cashiering Manager
Abbie French, Internal Audits

FINDING 1 The department needs to maintain full accountability of agency check stocks.

The DCA concurs with this finding and recommendations.

- The CCU unit and the CalStars unit will develop and implement procedures to include proper securing of blank checks at all times.
- A Transfer form will be developed by February 1, 2008. The CCU unit and the CalStars unit will train staff on the use of the transfer form when handling checks.
- The CCU has discontinued the practice of removing blank checks from the stock box until they are ready to type the check.

FINDING 2 Agency checks are not always processed properly or timely issued.

The DCA concurs with this finding and recommendations.

- The department will develop and implement procedures to provide the roles and responsibilities of staff involved with the processing of agency checks.
- Once procedures are developed staff will be trained.
- The goal for processing the checks will be on average 5 working days.

FINDING 3 Control over the check signing machine keys and facsimile hand stamps are inadequate.

The DCA concurs with this finding and recommendations.

- CCU will develop and implement procedures to control the check signing machine keys.
- When assigning the keys for the check signing machine proper separation of duties will be implemented.
- Facsimile hand stamps containing the Fiscal Officer's signature (4) and the CalStars Manager's (2) signature have been destroyed. See attached documentation.
- One facsimile hand stamp containing the Fiscal Officer's signature will be retained in case the check signing machine should malfunction. The facsimile hand stamp is now locked and under the control of the Fiscal Officer.

A

FINDING 4 Inadequate separation of duties over the handling of agency checks.

DCA concurs with this finding and recommendations.

- The DCA is currently reviewing and implementing changes to ensure compliance with separation of duties. All reassignments will be accomplished by February 1, 2008.

FINDING 5 Complete records of signed checks are not maintained to ensure accurate reconciliation.

DCA concurs with this finding and recommendations.

- The department is now logging all checks signed by machine and hand.

Destruction of Facsimile Signature Rubber Stamps
January 25, 2008

8001.4 FACSIMILE SIGNATURE (SIGNATURE PLATE OR RUBBER STAMP)
DESTRUCTION
(Revised 7/79)

Agencies shall destroy the facsimile signature plate upon the departure of the particular authorized officer. Two persons, exclusive of the individual whose signature is involved, shall witness and sign an acknowledgment of the destruction. One copy shall be given to the departing officer and one shall be retained and filed by the agency.

Agencies shall use any convenient method of destruction. Suggested methods for signature plate destruction are to saw in half or hammer or file imprint down. For rubber stamps, the imprint should be removed from the stamp and cut with scissors.

Stamps Destroyed

Pamela S. Wortman

4 stamps

Pamela S. Wortman

1-25-08

Mary Cather

2 stamps

Mary Cather

1/25/2008

Destruction was witnessed by

Abbie French, Auditor 2/25/08

Susan J. Bennett Miller, MST 1/25/08



ATTACHMENT II

Auditor's Comments on the Department's Response

Auditor's Comments on the Department's Response

To provide our perspective on the department's response to our audit finding related to the control over the check signing machine keys and facsimile hand stamps, we are commenting on this issue below. The letter to the left corresponds with the letter placed in the board's response.

A

The audit report identifies the department not having the required authorization from the Department of Finance (DOF) to use rubber stamped signatures to sign checks. If the department intends on retaining a facsimile stamp for cases where the check signing machine malfunctions, the department must obtain DOF authorization to use the facsimile stamp (SAM 8082).

SAM Section 8082 states that departments considering use of rubber stamp facsimile signatures for check signing contact DOF, Fiscal Systems and Consulting Unit, for authorization.